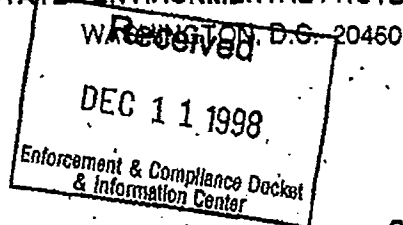


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## UNITED STATES ENVIRONMENTAL PROTECTION AGENCY



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OFFICE OF  
ENFORCEMENT AND  
COMPLIANCE ASSURANCEMEMORANDUM

**SUBJECT:** General Policy on Superfund Ability to Pay Determinations

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This memorandum transmits a policy document developed by the Office of Site Remediation Enforcement (OSRE) that explains what is necessary for an acceptable ability to pay (ATP) settlement in Superfund cases. The main text of the policy document addresses general issues that apply to the ATP process and ATP settlements. The policy document also contains two appendices that address issues specific to making ATP determinations for individuals and businesses.

The policy document is directed primarily toward Office of Regional Counsel (ORC) and Superfund enforcement program staff who handle cases involving ATP issues. It should also be useful for potentially responsible parties (PRPs) who believe that they are unable to pay their share of Superfund cleanup costs, as well as for other PRPs at sites where ATP claims are raised.

This policy document is the second Superfund ATP document issued by OSRE. In May 1995 OSRE issued a "short sheet" guidance document, entitled "Overview of Ability to Pay Guidance and Models," which describes policies and models relevant to Superfund ATP analyses.

The policy document establishes an "undue financial hardship" standard for determining a party's ability to pay its share of Superfund cleanup costs, and uses a two-part analysis to

## GENERAL POLICY ON SUPERFUND ABILITY TO PAY DETERMINATIONS

### INTRODUCTION

This document provides a general policy framework for settlements in which a party's financial ability to pay is a significant consideration ("ATP settlement") under the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA" or "Superfund"). The United States may enter into ATP settlements with individuals and businesses for recovery of response costs and performance of cleanup work in appropriate cases. The purpose of this policy is to provide guidance to EPA enforcement personnel, affected parties, and the public on the information that EPA will look at in evaluating proposals to enter into an ATP settlement, and the steps that Agency personnel should follow in evaluating a party's inability to pay claim.

The ATP settlement process is reserved for business potentially responsible parties ("PRPs") who demonstrate to EPA's satisfaction that payment of the amount sought by the government is likely to put a company out of business or otherwise jeopardize its viability, and for both business and individual PRPs who demonstrate to the Agency that payment of such an amount is likely to create an undue financial hardship. The ATP settlement process may provide for a reduction in the proposed settlement to an amount that is not likely to create an undue financial hardship. An undue financial hardship occurs if, in the opinion of EPA, satisfaction of the environmental claim will deprive a PRP of ordinary and necessary assets or cause a PRP to be unable to pay for ordinary and necessary business expenses and/or ordinary and necessary living expenses.

This document first presents a general overview of ATP settlements. It then discusses the types of analysis that should be conducted in a case where an ATP settlement has been requested by a PRP, and generally describes how EPA enforcement personnel working on a Superfund case and, where applicable, Department of Justice (DOJ) staff ("the case team") should determine an amount that represents the ability of a particular PRP to pay for response costs or work ("ATP amount"). This document does not cover the final settlement amount that the Agency should accept. There may be situations in which ability to pay is not the only factor on which the settlement is based.

This document also includes appendices that address ATP issues arising in settlements with individuals (Appendix A) and businesses (Appendix B). These appendices provide supplemental information on the analysis of ATP claims and the determination of ATP amounts for individuals and businesses. Although Appendix B was developed primarily to expedite the processing of ATP claims by small businesses, its principles apply to business

require very much input, and that may be particularly useful in screening ATP claims made by a large number of PRPs at a Superfund site.

These computer models and protocols, which require the input of financial information, are useful in evaluating financial strengths and weaknesses of a PRP. However, they lack the capability to evaluate the quality of the financial information and to consider all aspects of a PRP's financial condition necessary to make financial projections. Due to these limitations, computer models and protocols should be used in screening and prioritizing ATP settlement requests but should not be the basis for entering into an ATP settlement. The opinion of the case team in conjunction with the opinion of a financial analyst should be the basis for the ATP settlement.

#### VERIFICATION

After the initial review, the financial information should be verified. The purpose of the verification process is to determine if the information can be relied upon to express an opinion concerning the effect of the proposed settlement amount on the ATP Candidate.

Information that has been submitted should be verified and the explanation of any discrepancies documented. This verification may require that the ATP Candidate produce receipts for large or unusual expenses, submit an appraisal report to verify the value of an asset purchased or sold, and submit other documentation to substantiate the financial information provided by the ATP Candidate. The amount of substantiating documentation for the ATP settlement is based on case specific needs. The size of the business and the complexity of the financial picture of the business or individual ATP Candidate are important factors in determining what is needed to verify the information. It is anticipated that, in every instance, EPA should perform some minimum verification prior to accepting information as submitted. In the event that the verification process identifies significant contradictions within the financial information, it may be appropriate to preclude any further consideration of an ATP settlement with this candidate.

When estimating borrowing capacity, EPA should determine if the ATP Candidate has overstated its liabilities. Questions relating to the status of a liability should be documented and a determination concerning the priority of the liability in comparison to the environmental claim should be made.

The ATP Candidate should also be required to certify that the ATP Candidate has made a full and accurate disclosure of financial information. The certification can be in the form of a signed statement from the ATP Candidate that is similar to

known that an owner has significant personal assets) and/or through unencumbered assets (i.e., assets that have no outstanding liens or pledges against them).

#### ESTABLISHMENT OF THE ATP AMOUNT

Any type of credit analysis, including the assessment of a ATP Candidate's ability to pay Superfund cleanup costs, involves many judgments with regard to issues like what constitutes an ordinary and necessary asset or expense, what projected future earnings and available cash flow are likely to be, and whether a capital expenditure can be reasonably delayed. It is important for the case team and the analyst to obtain necessary information from the business entity or individual pertaining to these difficult decisions in order to reasonably arrive at an appropriate ability to pay determination.

Once the case team is assured that all requested financial information has been obtained and analyzed, Available Income (as defined above), amounts available from estimated borrowing capacity, amounts available from the sale of assets that are not ordinary and necessary, and amounts available from owners' equity should be identified and added together. This sum should then be reduced by an appropriate safety factor to reflect the uncertainties in making predictions for a specific ATP Candidate, and to provide for unexpected events. The safety factor can be a percentage adjustment, a dollar estimate or some other adjustment that is appropriate to the analysis and should be determined on a case by case basis. The amount produced by this step is the estimated ATP amount. Another quick review of the ATP Candidate's financial situation should be conducted to assure that the analysis is complete and accurate. If this review indicates that the ATP Candidate can pay the estimated ATP amount, that amount should be recommended as the ATP amount.<sup>4</sup> If the review does not produce such a result, the estimated ATP amount should be revisited.

Once the ATP amount has been established, EPA should seek settlement rapidly since the financial condition of an ATP Candidate may change. If there is an extended delay between the analysis and the settlement, the financial condition of the ATP Candidate may change and EPA's information may be stale.

In evaluating the amount that an ATP Candidate can afford to pay in a settlement, one consideration is how the payment will be structured in the settlement agreement, namely a one-time payment versus installment payments. For example, an ATP Candidate's ability to generate future income may be used to fund installment

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<sup>4</sup>Any ATP settlement recommendation in a case involving the Department of Justice is subject to DOJ approval.

## APPENDIX B: BUSINESS ABILITY TO PAY DETERMINATIONS

### APPLICABILITY

Businesses can be broadly grouped into three categories: corporations, partnerships, and sole proprietorships. From the perspective of analyzing the financial health of a business, a critical distinction exists among these categories regarding the extent to which the business' owners are responsible for the business' liabilities. A corporation is an entity in which ownership is established by parties (who may be individuals, partnerships, or other corporations) who hold shares of stock in that corporation. The corporation under the law has the status of a person. Therefore, liability generally is limited to the corporation. A corporation's owners (i.e., shareholders) generally enjoy limited liability for any of the corporation's debts or legal claims, and the most they can "lose" is the value of their investments (i.e., stock) in the firm. In assessing the financial health of a corporation, only the financial resources of the corporation are relevant.

The owner of a sole proprietorship, in contrast, is not protected from business debts, and the owner has unlimited liability for his business. The total financial resources and financial responsibilities of the owner of a sole proprietorship or the partners of a general partnership should be evaluated in assessing the ability of these entities to pay.

A less common form of partnership is known as a "limited partnership." These partnerships consist of one or more limited partners (whose liability for the partnership's debts is limited to the amount of money originally invested) and one or more general partners (whose liability for partnership debts is not limited to the amount of their investment).

For purposes of analyzing ability to pay situations, it may be necessary to consult one or both of the appendices. For example, ATP settlements affecting businesses enjoying limited liability (e.g., corporations) should be determined in accordance with the policy set forth in Appendix B and the main body of this policy document. However, business entities who have general liability (e.g., sole proprietorship) are addressed in Appendix A: Individual Ability to Pay Determinations.

### PURPOSE OF BUSINESS ABILITY TO PAY SETTLEMENTS

EPA does not intend the Superfund settlement process to result in the closing of a business or the inability of a business to conduct its business activities. For this reason an ATP settlement with a business PRP is permitted if the business PRP (the "ATP Candidate") demonstrates that the payment of a

certain sum of money is beyond its financial capability and that settling for such a sum of money would create an undue financial hardship for the ATP Candidate. The business ATP settlement should also meet the requirements contained in the main body of this policy document.

EPA's analysis of the financial condition of the ATP Candidate should be performed with the assistance of a person who is qualified to make this determination. If the analysis identifies available sources of funds that exceed the proposed settlement amount, there should be no reduction in this amount.

#### INITIAL REVIEW

The ATP Candidate should provide EPA with sufficient financial information on which to base an ATP settlement decision. Generally, the ATP Candidate should be required to provide a minimum of the five most recent years of federal corporate income tax returns. Similarly, the Agency should also generally request the five most recent years of financial information (audited, if available) and a completed financial questionnaire. Other information, as determined by EPA, should be provided and reviewed by EPA. This may include loan applications, financial information relating to other entities owned by the business and/or shareholders or directors of the business, financial information for a period of time greater than five years, and information that might assist in estimating the fair market value of assets, liabilities, income and expenses of the ATP Candidate.

The initial review should characterize the financial condition of the ATP Candidate in terms of income and net worth. The initial review may:

- 1) Compare the ATP Candidate's income and expenses with similar businesses<sup>7</sup>;
- 2) Calculate various financial ratios (e.g., debt-to-equity ratio) that help to describe the equity, solvency and profitability of the ATP Candidate; and
- 3) Compare net income and cash flow projections with the proposed settlement amount.

If a preliminary review of the financial information indicates that the proposed settlement amount is not significant in comparison to the financial position of the ATP Candidate, the

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<sup>7</sup>For example, information on officers' compensation is available in the Robert Morris Associates business profiles. For further information on how to make these comparisons, see the "Beyond ABEL Training Course" materials.